

**The Internal Revenue Service Can Improve Its
Electronic Return Preparer Fraud Activities**

September 1999

Reference Number: 199940062



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

September 13, 1999

MEMORANDUM FOR COMMISSIONER ROSSOTTI

FROM: Pamela J. Gardiner
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – The Internal Revenue Service Can Improve
Its Electronic Return Preparer Fraud Activities

This report presents the results of our review of the Internal Revenue Service's (IRS) efforts to detect and deter preparer fraud in its electronic filing (*e-file*) program. We conducted this audit as part of our overall review of the IRS' Revenue Protection Strategy to evaluate the effectiveness of electronic return activities. Specifically, our objective was to assess if recommendations, made in a prior IRS Inspection Service (now Treasury Inspector General for Tax Administration) Audit Report on *Electronic Return Preparer Fraud (Reference Number 045601)*, were effectively implemented.

Overall, we found IRS management generally implemented corrective actions addressing recommendations contained in the prior review. Specifically, the IRS' Criminal Investigation (CI) function implemented the Return Preparer Program (RPP) to protect revenue by identifying, investigating, and prosecuting abusive return preparers. The Office of Electronic Tax Administration (ETA) established procedures to identify and remove dishonest electronic return preparers and strengthened admittance standards to reduce the number of abusive preparers in the *e-file* program. Additionally, procedures are in place to ensure that unscrupulous preparers are referred to the Examination function for appropriate actions.

However, CI can improve the effectiveness of the RPP by increasing emphasis and oversight over RPP activities. In addition, ETA management can improve controls over the removal of dishonest electronic return preparers by separating the duties performed by ETA district coordinators.

We recommended that the IRS establish overall authority and functional responsibility for the RPP program and provide adequate resources for RPP activities. We also recommended that IRS assign responsibility for the removal of noncompliant return preparers to someone other than the district ETA coordinator.

IRS management agreed with our recommendations. Their comments have been incorporated in the report where appropriate, and the full text of management's response is included as an appendix.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions, or your staff may call Walter Arrison, Associate Inspector General for Audit (Wage and Investment Income Programs), at (770) 455-2475.

**The Internal Revenue Service Can Improve Its Electronic
Return Preparer Fraud Activities**

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The Internal Revenue Service Can Improve Its Electronic Return Preparer Fraud Activities

Executive Summary

This follow-up review relates to the important area of revenue protection and addresses the Internal Revenue Service's (IRS) efforts to detect and deter electronic return preparer fraud. The Criminal Investigation (CI) function implemented the Return Preparer Program (RPP) in 1996 to protect revenue by identifying, investigating, and prosecuting abusive return preparers (including both electronic and paper returns).

Our overall objective was to assess whether the IRS effectively implemented corrective actions contained in a 1994 IRS Inspection Service (now Treasury Inspector General for Tax Administration) Audit Report on *Electronic Return Preparer Fraud (Reference Number 045601)*. As a result of the prior review, the CI function established a multi-functional national RPP to address preparer fraud. The Office of Electronic Tax Administration (ETA) established procedures to remove dishonest electronic return preparers and to perform visitations on suspicious preparers to ensure compliance with electronic filing (*e-file*) procedures. ETA also strengthened admittance standards to reduce the number of abusive preparers in the *e-file* program. Additionally, the IRS established procedures to ensure that unscrupulous preparers are referred to the Examination function for penalty assessment or prohibition from participation in the *e-file* program.

However, CI can improve the effectiveness of the RPP by increasing emphasis and oversight. Additionally, ETA can improve controls over the removal of dishonest *e-file* preparers by separating duties performed by district ETA coordinators.

Results

IRS management generally implemented corrective actions addressing the recommendations made in the prior review noted above. However, the effectiveness of electronic return preparer activities can be improved. Specifically:

The Internal Revenue Service Can Provide Increased Emphasis and Oversight to Return Preparer Activities

Additional resources are needed to better address return preparer schemes. Service Center Criminal Investigation Branches (CIB) did not always have full-time resources devoted to identifying return preparer schemes, and CI field personnel did not always consider the RPP as a priority or mandated program. Additionally, there was no document that established overall authority and functional responsibility for this program.

The Internal Revenue Service Can Improve Its Electronic Return Preparer Fraud Activities

Although CI was responsible for leading the multi-functional RPP, no national analyst was dedicated to coordinate RPP activities for most of calendar year 1998.

The Internal Revenue Service Can Improve the Control Over the Removal of Dishonest Electronic Return Preparers

The ETA function established procedures for removing dishonest return preparers from the *e-file* program. However, this process can be improved by separating the duties that the district ETA coordinators perform. These officials are responsible for promoting *e-file* and removing noncompliant electronic preparers. These are key duties that involve conflicting goals.

Summary of Recommendations

To address the issues identified in this report, we recommended that the IRS provide adequate resources for RPP activities, develop procedures establishing CI as the lead office for the RPP, and that CI assign a full-time analyst to coordinate the RPP. In addition, we recommended that the IRS assign responsibility for the removal of noncompliant return preparers to someone other than the district ETA coordinator.

Management's Response: IRS management agreed with our recommendations and, beginning in Fiscal Year (FY) 2000, will provide increased resources to RPP activities. Additionally, a Servicewide Return Preparer Strategy is planned for implementation in FY 2000 focusing on return preparers who prepare Earned Income Tax Credit returns. As part of this strategy, a memorandum of understanding is being developed to clearly define CI as being responsible for the fraud aspect of the strategy. Future efforts will address additional areas of abuse as identified.

ETA will coordinate with Examination to assume responsibility for monitoring and removal of noncompliant electronic return originators. As a result, the duties of the ETA coordinators will no longer include compliance-type activities.

Management's complete response to the draft report is included as Appendix IV.

The Internal Revenue Service Can Improve Its Electronic Return Preparer Fraud Activities

Objective and Scope

We performed this follow-up review to provide Internal Revenue Service (IRS) management with an assessment of the effectiveness of corrective actions implemented in response to a September 21, 1994, IRS Inspection Service (now Treasury Inspector General for Tax Administration) Audit Report on *Electronic Return Preparer Fraud* (Reference Number 045601).

Our overall objective was to assess whether the IRS implemented corrective actions specified in the 1994 report on Electronic Return Preparer Fraud.

Our overall objective was to assess whether the IRS implemented corrective actions specified in the 1994 report noted above. To accomplish this objective, we:

- Determined whether Criminal Investigation (CI) established an effective Return Preparer Program (RPP) with specialized objectives, procedures, and resources to deal with electronic return preparer fraud.
- Determined if the IRS established and implemented procedures for removing dishonest return preparers from the electronic filing (*e-file*) program.
- Determined if procedures were established to ensure that unscrupulous return preparers, identified by IRS reviews, are referred to Examination for penalty assessment or prohibition from participation in the *e-file* program.
- Assessed whether admittance standards for *e-file* were strengthened to reduce the number of unscrupulous preparers in the program.

Our work on this follow-up review was performed at the IRS National Office functions including CI, Examination and Electronic Tax Administration (ETA), four service centers (Andover, Atlanta, Austin, and Brookhaven), and three districts (Georgia, New England, and South Texas). We also performed work at the Office of the Director of Practice and contacted the Criminal Investigation Branch (CIB) staff at the Fresno Service Center. Audit work was conducted from

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October 1998 through February 1999. This review was performed in accordance with *Government Auditing Standards*.

Details of our audit objective, scope, and methodology are presented in Appendix I. Major contributors to this report are listed in Appendix II.

Background

As a result of the 1994 report on *Electronic Return Preparer Fraud (Reference Number 045601)*, the IRS agreed to establish a multi-functional national RPP. CI was designated to lead and coordinate this program. Specifically, CI agreed to coordinate RPP activities with other IRS functions and to provide resources to staff and fund program activities. Additionally, detailed procedures and guidelines were to be developed for determining which cases will be sent to CI or Examination.

CI and other IRS compliance functions, at the service centers and district offices, identify preparers engaged in fraudulent activity. The initial identification of questionable returns occurs on a return by return basis by IRS personnel. When indications of fraudulent activity by return preparers are discovered, CI may initiate an investigation and later recommend prosecution. In suspected schemes where the identification of additional returns does not appear to be leading to a criminal referral, the case should be referred for examination.

Return preparer fraud involves the preparation and filing of false income tax returns (in either *paper* or *electronic* form). The RPP was implemented in 1996 to protect revenue by identifying, investigating, and prosecuting abusive return preparers, including *e-file* preparers.

The Internal Revenue Service Can Improve Its Electronic Return Preparer Fraud Activities

Results

The IRS generally implemented corrective actions addressing recommendations contained in the report on Electronic Return Preparer Fraud.

The IRS generally implemented corrective actions addressing recommendations contained in the 1994 report on *Electronic Return Preparer Fraud*. Specifically, CI established a multi-functional national RPP to address preparer fraud. ETA established and implemented procedures to remove dishonest *e-file* preparers and to perform visitations on suspicious preparers to ensure compliance with *e-file* procedures. ETA also strengthened admittance standards to reduce the number of abusive preparers in the *e-file* program. Additionally, procedures are in place to ensure that unscrupulous preparers are referred to Examination for penalty assessment or prohibition from participation in the *e-file* program.

The following chart shows that CI has attained positive results from return preparer activities:

Return Preparer Statistics

	Fiscal Year 1995	Fiscal Year 1996	Fiscal Year 1997	Fiscal Year 1998
Preparers Indicted	52	75	112	105
Preparers Convicted	42	74	84	92
Preparers Sentenced	Not Available	Not Available	Not Available	83

CI can improve the effectiveness of the RPP by providing increased emphasis and oversight. Additionally, ETA controls can be improved over the removal of dishonest electronic return preparers from the program by providing for separation of duties for ETA district personnel. These duties relate to promoting participation in the *e-file* program and removing noncompliant preparers.

The Internal Revenue Service Can Improve Its Electronic Return Preparer Fraud Activities

The Internal Revenue Service Can Provide Increased Emphasis and Oversight to Return Preparer Activities

Actions can be taken to better ensure that RPP activities are effectively performed. In addition, CI can provide increased emphasis and oversight.

We determined that: (1) CIBs did not always have full-time resources devoted to the RPP; (2) CI did not establish program roles and responsibilities through any formal document; and (3) CI did not have an analyst or other official dedicated to oversee or coordinate return preparer activities for much of 1998.

CI committed to take the lead and coordinate a multi-functional RPP in its response to the 1994 report on *Electronic Return Preparer Fraud*. Additional resources would be provided to staff and fund the RPP in the CIBs. CI management also noted that increased compliance checks (visitations) to identify suspicious return preparers would be stressed.

Additional emphasis and resources are necessary to better address return preparer schemes

CI field personnel did not always consider the RPP a priority or mandated program.

We found that CI field personnel did not always consider the RPP as a priority or mandated program. CIBs generally did not have full-time resources devoted to developing return preparer schemes.

Interviews with CIB branch chiefs and examiners at five service centers indicated that field personnel did not consider the RPP as a priority or mandated by the National Office. At three of five CIBs contacted, return preparer scheme work was carried out on a part-time basis using staff from another CI activity, the Questionable Refund Program (QRP). Due to the priority placed on the QRP, CIBs did not receive staffing and funding for the RPP until February 1998. This staffing was received as a result of the Earned Income Tax Credit (EITC) initiative. Criminal Investigation then committed to assign up to two

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full-time employees at each center to develop EITC criminal referrals.

Limited district CI and Examination resources could adversely affect the RPP. CIB personnel at two of four locations visited noted that district offices do not accept many schemes due to the lack of resources. For instance, 1 CIB identified 20 return preparer schemes that were not accepted due to a lack of resources. Another CIB identified an average of 28 schemes annually over 3 years, but noted that many cases were not accepted by district CI or Examination due to a lack of resources.

CIB personnel at another location referred 130 return preparer schemes in the last 3 years but stated that other less flagrant schemes were not always fully developed. This situation was attributed to the perception that CI or Examination would reject these cases due to lack of resources or interest.

Further, information provided by 1 CIB showed that \$13.9 million in questionable refunds were released over a two-year period due to limited Examination resources to audit the returns.

Better coordination and increased oversight can be provided for return preparer activities

We did not identify any documentation that established overall authority and functional responsibilities for the RPP. Additionally, although CI was responsible for leading the RPP, there was no national analyst assigned this responsibility for much of 1998.

Interviews with CI, ETA, Examination and Director of Practice officials showed that there is no formal document establishing program roles and responsibilities. This document should include functional responsibilities and requirements for coordination, as well as resource commitments.

Although CI designated the RPP as a national priority, the CI analyst responsible for monitoring the program left this position in April 1998 and was not replaced

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CI cited limited compliance resources as a problem related to working return preparer cases.

until January 1999. During this period, no analyst was assigned responsibility for monitoring the RPP.

An August 1998 CI memorandum to the Chief Operations Officer noted that little progress was made over the last few years to identify, develop, and refer preparer cases. Limited resources, lack of interest, and deviations from guidelines were cited as reasons. Problems in monitoring and capturing data on results were also noted. We also found that there were limited resources and emphasis for the RPP.

Increased oversight and emphasis will better ensure that return preparer schemes are effectively identified, developed, and referred for appropriate action.

Recommendations

1. Ensure that adequate resources are provided for the identification and development of return preparer schemes.

Management's Response: For Fiscal Year (FY) 2000, Service Center CIBs will be allocating increased resources (up to 61 full-time equivalent positions) to research and develop preparer schemes. A Servicewide Return Preparer Strategy is planned for implementation in FY 2000. This strategy will focus on return preparers who prepare Earned Income Tax Credit returns. Additionally, IRS guidelines for preparer schemes will be changed to ensure the monitoring and tracking of these investigations.

2. Develop procedures that clearly establish CI as the lead office for the RPP to better ensure that activities can be effectively coordinated cross-functionally. A memorandum of understanding or similar document should be prepared to specify cross-functional responsibilities (CI, Examination, and the ETA) and to obtain functional commitment to the RPP.

Management's Response: As part of the FY 2000 Return Preparer Compliance Strategy, a Memorandum of Understanding (MOU) is being developed to clearly

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define CI as the responsible organization for the fraud aspect of the strategy. CI will assist other compliance functions in the identification of abusive preparers. The Assistant Commissioner (Research and Statistics of Income) will be the lead office for coordinating other areas of the strategy. The strategy co-owners will continue to be the National Director, Tax Refund Fraud and the Assistant Commissioner (Research and Statistics of Income). In addition, the IRS has established a multi-functional team and developed an integrated compliance and education strategy.

3. Ensure that CI assigns the responsibility for monitoring and coordinating the RPP to a national program analyst on a full-time and on-going basis.

Management's Response: Since January 1999, an analyst has been assigned full-time to the RPP.

The Internal Revenue Service Can Improve the Control Over the Removal of Dishonest Electronic Return Preparers

ETA duties related to removing dishonest return preparers should be separated.

ETA implemented procedures for removing dishonest return preparers from the IRS *e-file* program. This process can be improved by separating the duties that the ETA district coordinators perform. These duties pertain to promoting participation in the IRS *e-file* program and removing noncompliant preparers.

IRS Revenue Procedures provide that the IRS can immediately suspend an *e-file* preparer from the program. The ETA coordinator facilitates the removal of dishonest *e-filers* (including return preparers) by serving as the contact point for all compliance functions and by obtaining the approval of the district director. The ETA coordinator then notifies the Andover Service Center that has responsibility for removing *e-filers* violating IRS Revenue Procedure provisions.

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District ETA coordinators perform duties that could be perceived as a conflict of interest

District ETA coordinators perform duties related to both promoting and increasing participation in the IRS *e-file* program, as well as removing electronic preparers who do not comply with established Revenue Procedures. These are key duties that involve conflicting goals.

Two of three district ETA coordinators interviewed expressed concerns that there is a conflict in promoting the IRS *e-file* program and removing noncompliant preparers. This concern pertains to a potential reluctance to remove noncompliant preparers, considering their duties in promoting participation in the program.

ETA coordinators have been assigned these potentially conflicting duties since the *e-file* program began. ETA officials were unsure as to why these potentially conflicting duties were assigned to ETA coordinators.

Sound management practices provide that key duties be separated among individuals. Assignment of duties and responsibilities to a number of individuals help to ensure that effective checks and balances exist.

The perception of conflicting responsibilities exists when the same individual performs duties related to both promoting IRS *e-file* participation and removing noncompliant preparers.

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Recommendation

4. Assign responsibility for the removal of noncompliant return preparers to someone other than the district ETA coordinator.

Management's Response: Plans are being made for district ETA coordinators to perform account management and/or to promote and market the *e-file* program. Their duties will no longer include compliance activities that could be perceived as a conflict of interest.

ETA will coordinate with Examination to assume responsibility for monitoring and removal of noncompliant electronic return originators.

Conclusion

The IRS generally implemented corrective actions addressing recommendations contained in the 1994 report on *Electronic Return Preparer Fraud*. Specifically, CI established a multi-functional national RPP to address preparer fraud. ETA established and implemented procedures to remove dishonest electronic return preparers and to perform visitations on suspicious preparers to ensure compliance with *e-file* procedures. ETA also strengthened admittance standards to reduce the number of abusive preparers in the *e-file* program. Additionally, procedures are in place to ensure that unscrupulous preparers are referred to Examination for penalty assessment or prohibition from participation in the *e-file* program.

However, CI can improve the effectiveness of the RPP by providing increased emphasis and oversight. Additionally, controls over the removal of dishonest preparers can be improved by providing for separation of duties for ETA district personnel. These duties relate to promoting participation in the *e-file* program and removing noncompliant preparers.

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Appendix I

Detailed Objective, Scope, and Methodology

The objective of the review was to assess whether the Internal Revenue Service (IRS) effectively implemented corrective actions contained in a 1994 IRS Inspection Service (now Treasury Inspector General for Tax Administration) Audit Report on *Electronic Return Preparer Fraud (Reference Number 045601)*. We determined whether the IRS established a Return Preparer Program (RPP) to include identifying and removing dishonest preparers from the electronic filing (*e-file*) program.

To accomplish the overall objective, we performed the following audit tests:

- I. Evaluated whether Criminal Investigation (CI) established an effective RPP with specialized objectives, procedures, and resources to deal with *e-file* preparers by:
 - A. Determining if a multi-functional national RPP was established, led and coordinated by CI.
 - B. Identifying and assessing existing RPP objectives and procedures as they relate to *e-file* return preparers.
 - C. Ascertaining whether CI provided additional resources to staff and fund the RPP in the service centers.
- II. Determined if the IRS established and implemented procedures for removing dishonest return preparers from the *e-file* program, including the performance of compliance checks on suspicious preparers to detect violations of revenue procedures by:
 - A. Determining if branch chiefs with *e-file* responsibilities in the service centers and district return preparer coordinators have the authority to suspend preparers who do not comply with requirements during the filing season.
 - B. Determining if districts are carrying out *e-file* visitations with cross-functional teams to coordinate fraud awareness, prevention, and detection.
- III. Assessed whether unscrupulous *e-file* preparers identified during compliance checks, Questionable Refund Detection Team reviews, or CI reviews are referred to Examination for appropriate actions by ascertaining that procedures in place and used by the functional groups noted above ensure that dishonest return preparers are referred to Examination for appropriate penalties.

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- IV. Determined if *e-filing* preparer admittance standards were tightened to reduce the number of unscrupulous preparers in the program by ensuring that *e-file* requirements reflect preparer admittance standards that were changed to protect system integrity.

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Return Preparer Fraud Activities**

Appendix II

Major Contributors to This Report

Walter Arrison, Associate Inspector General for Audit (Wage & Investment Income Programs)

Kerry Kilpatrick, Director

Mark Nathan, Audit Manager

John O'Rourke, Senior Auditor

John Piecuch, Senior Auditor

Donald Martineau, Auditor

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Appendix III

Report Distribution List

Chief Operations Officer OP

Assistant Commissioner (Criminal Investigation) OP:CI

Assistant Commissioner (Electronic Tax Administration) OP:ETA

Assistant Commissioner (Examination) OP:EX

Assistant Commissioner (Program Evaluation and Risk Analysis) M:OP

Assistant Commissioner (Research & Statistics of Income) OP:RS

Executive Officer for Service Center Operations OP:SC

National Director for Legislative Affairs CL:LA

Office of Management Controls M:CFO:A:M

Audit Liaisons:

Assistant Commissioner (Criminal Investigation) OP:CI:PI

Assistant Commissioner (Electronic Tax Administration) OP:ETA

Assistant Commissioner (Examination) OP:EX:MA

Executive Officer for Service Center Operations OP:SC:CS:S

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Appendix IV

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

August 12, 1999

OFFICE OF TREASURY
INSPECTOR GENERAL
RECEIVED

1999 AUG 20 A 9:59

MEMORANDUM FOR TREASURY INSPECTOR GENERAL FOR
TAX ADMINISTRATION FOR TAX ADMINISTRATION

FROM: Charles O. Rossotti
Commissioner of Internal Revenue

SUBJECT: Draft Treasury Inspector General for Tax Administration (TIGTA)
Audit Report—The Internal Revenue Service (IRS) Can
Improve Its Electronic Return Preparer Fraud Activities

Thank you for the opportunity to respond to your draft report dated June 17, 1999. Fraud prevention and detection is extremely important to the IRS.

The IRS understands that since more than 50 percent of the tax returns filed are completed by return preparers, there is a need to ensure that the return preparers are assisting in the compliance effort. To that end, the IRS initiated a Return Preparer Program in 1996 and established procedures to protect the revenue by identifying, investigating, and prosecuting abusive return preparers. The program was developed to enhance compliance in the return-preparer community by engaging in enforcement actions and/or asserting appropriate civil penalties against unscrupulous or incompetent return preparers.

To enhance this ongoing Criminal Investigation effort, the IRS is putting in place a multifunctional Return Preparer Strategy for implementation in the early part of Fiscal Year 2000. This effort will be comprised of education, compliance, examination, and criminal enforcement. This particular effort will be targeted on the area of the earned income tax credit since recent statistical information has shown that this is a particularly abusive item. Future efforts will address additional areas of abuse as identified.

We appreciate your efforts in support of our objectives to provide the necessary controls, while striving to encourage voluntary compliance. Attached are responses to the four recommendations in the draft report.

Questions regarding this response should be directed to Gary D. Bell, National Director (Tax Refund Fraud), OP:CI:ORF, at (202) 622-7140, or Bill Turner of his staff at (202) 622-7795.

Attachments (2)

cc: Assistant Commissioner (Electronic Tax Administration) OP:ETA
Assistant Commissioner (Examination) OP:EX
Assistant Commissioner (Research & Statistics of Income) OP:RS

The Internal Revenue Service Can Improve Its Electronic Return Preparer Fraud Activities

ATTACHMENT 1

Response to Draft TIGTA Report "The Internal Revenue Service (IRS) Can Improve Its Electronic Return Preparer Fraud Activities" July 23, 1999

IDENTITY OF RECOMMENDATION #1

Ensure that adequate resources are provided for the identification and development of return preparer schemes.

ASSESSMENT OF CAUSE(S)

Although the Return Preparer Program (RPP) was identified as a priority within Criminal Investigation's (CI) Annual Business Plan for FY 1999, approximately 2 FTEs per Service Center Criminal Investigation Branch (CIB) were allocated. Historically, working preparer cases in the district has been very labor-intensive due to the number of witnesses and also because the preparer program had to compete for limited district resources with other CID program priority areas.

CORRECTIVE ACTIONS

A Servicewide return preparer strategy is planned for implementation in Fiscal Year (FY) 2000. The FY 2000 strategy is focused on return preparers who prepare Earned Income Tax Credit (EITC) returns because of the high incidence of abuse associated with those returns. The strategy details compliance and outreach/education visitations for EITC practitioners. Future strategies will attempt to address other areas of abuse.

For FY 2000, the Service Center CIBs will be allocating up to 61 FTEs to research and develop preparer schemes.

The IRM will be changed to reflect that all Service Center Return Preparer schemes will be referred to the district office as a Primary Investigation effective October 1, 1999. This will enable us to monitor and track the progress of these investigations.

IMPLEMENTATION DATE:

Proposed – October 1999

RESPONSIBLE OFFICIAL(S)

Assistant Commissioner (Criminal Investigation) OP:CI

Assistant Commissioner (Research and Statistics of Income) OP:RS

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CORRECTIVE ACTION MONITORING PLAN

Examination will track and report preparer cases initiated and the related results. CI will track and report Primary and Subject Investigations of preparers through the Criminal Investigation Management Information System (CIMIS).

IDENTITY OF RECOMMENDATION #2

Develop procedures that clearly establish CI as the lead office for the RPP to better ensure those activities can be effectively coordinated cross-functionally. A memorandum of understanding (MOU) or similar document should be prepared to specify cross-functional responsibilities [CI, Examination, and Electronic Tax Administration (ETA)] and to obtain functional commitment to the RPP.

ASSESSMENT OF CAUSES

A memorandum from Acting Chief Compliance Officer James Donelson (attached) was issued in January 1996 providing revised instructions for working return preparer cases. The current ETA organization was not included in the memorandum. Following the release of the memorandum, there was no annual integrated plan to support those revised instructions.

CORRECTIVE ACTIONS

As part of the FY 2000 Return Preparer Compliance Strategy, an MOU is being developed. The MOU will clearly define CI as being the responsible organization for the fraud aspect of the strategy. CI will also assist in the identification of abusive preparers that will be addressed by other compliance functions. The Assistant Commissioner (Research and Statistics of Income) will be the lead office for coordinating other areas of the FY 2000 strategy. Therefore, the strategy co-owners will continue to be the National Director, Tax Refund Fraud, and the Assistant Commissioner (Research and Statistics of Income). Future strategies will continue to address abuse in EITC and other identified areas of abuse in a similar multifunctional approach.

A multifunctional team has been established and an integrated compliance and education strategy has been developed. Chief Communications and Liaison, Assistant Commissioner (Customer Service), Assistant Commissioner (Examination), Assistant Commissioner (ETA), representatives of the EITC Program Office, and several District Office Research and Analysis staffs are members of the cross-functional team.

IMPLEMENTATION DATE:

Proposed: January 2000

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RESPONSIBLE OFFICIAL(S)

Assistant Commissioner (Criminal Investigation) OP:CI
Assistant Commissioner (Research and Statistics of Income) OP:RS
Assistant Commissioner (Examination) OP:EX

CORRECTIVE ACTION(S) MONITORING PLAN

The multifunctional group is still in the process of developing a measurement program as part of the Servicewide Return Preparer Strategy.

IDENTITY OF RECOMMENDATION #3

Ensure that CI assigns the responsibility for monitoring and coordinating the RPP to a national program analyst on a full-time and ongoing basis.

ASSESSMENT OF CAUSE(S)

Due to the turnover in personnel, the Office of Refund Fraud was unable to have an analyst assigned full-time to the RPP.

CORRECTIVE ACTIONS

Since January 1999, an analyst is assigned full time to the RPP.

IMPLEMENTATION DATE:

Completed: January 1999

RESPONSIBLE OFFICIAL(S)

National Director, Tax Refund Fraud OP:CI:ORF

CORRECTIVE ACTION(S) MONITORING PLAN

The full-time analyst will maintain a liaison with counterparts from the Assistant Commissioner (CI), Office of Tax Crimes, and will receive relevant case data from the field as to the status of Return Preparer cases referred to the districts. In addition, the analyst will need to coordinate with the Service Center CIBs and Assistant Commissioner (Examination) regarding the Servicewide Return Preparer Strategy.

IDENTITY OF RECOMMENDATION #4

Assign responsibility for the removal of noncompliant return preparers to someone other than the district ETA Coordinator.

ASSESSMENT OF CAUSE(S)

The district ETA Coordinators perform duties related to both promoting increased participation in the IRS electronic filing (e-file) program, as well as removing electronic preparers who do not comply with established IRS Revenue Procedures. These duties involve conflicting goals.

The Internal Revenue Service Can Improve Its Electronic Return Preparer Fraud Activities

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CORRECTIVE ACTIONS

Plans are being made for district ETA Coordinators to perform account management and/or to promote and market e-file and e-file products. Their duties will include no compliance-type activities that could be perceived as a conflict of interest.

ETA will coordinate with Examination to assume responsibility for monitoring and removal of noncompliant Electronic Return Originators. All districts use teams of employees to perform monitoring visits. ETA Coordinators will not be included on those teams.

IMPLEMENTATION DATE:

Proposed: January 2000

RESPONSIBLE OFFICIAL(S)

Assistant Commissioner (Electronic Tax Administration) OP:ETA

Assistant Commissioner (Examination) OP:EX

CORRECTIVE ACTION(S) MONITORING PLAN

ETA will continue receiving periodic monitoring visit reports from each district and region. These reports provide data such as number of visits, types of visits, results of each visit, and time used for visits.

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ATTACHMENT 2



CHIEF COMPLIANCE OFFICER

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

JAN -2 1996

MEMORANDUM FOR REGIONAL COMMISSIONERS
SERVICE CENTER DIRECTORS
ASSISTANT COMMISSIONER (INTERNATIONAL) CP:IN

FROM: James E. Donelson
Acting Chief Compliance Officer CP

SUBJECT: Return Preparer Program

On August 14, 1995, we sent draft procedures to all of you for comments regarding the Return Preparers program. We appreciate all of the comments and input and have incorporated many of the recommended revisions. The final version of the return preparer procedures is attached for immediate district and service center distribution and implementation. Corresponding changes to the Internal Revenue Manual will be forthcoming. Additionally, a Return Preparer Audit Technique Guide will be developed at a later date.

The purpose of these procedures is to supplement the provisions of IRM (20) (11) 00 Preparer/Promoter/Protester Penalty Handbook, in addition to assisting the districts and service centers in the identification and administration of return preparer penalties as they relate to Internal Revenue Code sections 6694 and 6695 when the facts and circumstances indicate they are warranted. These procedures apply to both paper and electronic filers. The National Office is closely monitoring return preparer activity. Please advise us if you have any comments or suggestions concerning the implementation of these procedures.

If you have any questions a member of your staff may contact Hope Wilson (Examination), on (202) 401-4338, Lester L. Roberts III (Criminal Investigation), on (202) 622-3713, Aaron Welch (Returns Processing), on (202) 283-0367 and Elaine Beck (Service Center Examination), on (202) 622-3897.

Attachment

RECEIVED
JAN 19 1996
COMPLIANCE DIV.

RECEIVED
JAN 12 1996
DIRECTOR'S OFFICE
K.C.S.C.

Attachment

The Internal Revenue Service Can Improve Its Electronic Return Preparer Fraud Activities

Return Preparer Procedures

Introduction

The Tax Reform Act of 1975 provides penalty and enjoinder action provisions designed to enable the Service to more closely monitor the activities of the tax preparation industry. Return preparer penalties relate to Internal Revenue Code (IRC) sections 6694, 6695, 6700, 6701, 6713, 7407, and 7408. Internal Revenue Manual (IRM) (20)(11)00 contains Examination Division procedures as to when to consider preparer penalties as well as program responsibilities for the National, Regional and District Offices.

This document outlines procedures that should be followed by Districts and Service Centers in identifying and dealing with questionable return preparers and the returns, (paper and electronic) they prepared. The primary purpose of these procedures is to identify problem preparers, to present options for working returns completed by these preparers, and to assert the various return preparer penalties, if the facts indicate they are warranted. It is noted that penalty assertion is the key enforcement vehicle of the Service in dealing with non-compliant preparers.

The procedures as outlined herein are meant to supplement the Program Coordination Responsibilities as outlined in IRM (20)(11)12. They are intended to include activities from successful programs in various Districts and/or Service Centers. The mandatory provisions referred to in this document, i.e., IRM procedures, should be added to programs already in place to ensure consistency. Districts and/or Service Centers with no program in place may find that implementation of these procedures will produce program results which are more beneficial than examination of DIF returns. Districts that have not had an active return preparer program, may wish to conduct an orientation for Examination technical employees. The session may be conducted in a group meeting format in eight hours or less. The following areas should be covered:

- a. Explanation of the Return Preparer Penalty provisions.
- b. Examination and interview techniques.
- c. Procedural requirements for return preparer penalty cases.
- d. Referral of potential problem preparers to the Penalty Screening Committee (PSC).
- e. Referrals to the Director of Practice.

The major focus of this program is to address preparers that are the primary source of abusive returns. Each function should customize its approach in dealing with problem preparers based on the specific problems detected in their district and/or service center.

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District Responsibilities

I. Districts will initiate the following actions:

A. Each District Director will establish a multi-functional Penalty Screening Committee (PSC), which includes the District Office Electronic Filing Coordinator (DOEFC), Examination Return Preparer Coordinator (RPC) and a Criminal Investigation Division (CID) Representative. Contact will be made with Service Center representatives from the Criminal Investigation Branch (CIB) and Examination as needed. The team will be responsible for implementing the District's provisions of this document and IRM (20)(11)17, Preparer/Promoter/Protester Penalties Handbook. The committee should be in place as soon as possible after January 1, 1996.

B. In accordance with IRM (20)(11)12, one or more district managers should be designated by the District Director to be accountable for activities of the "committee" which are as follows:

1. Responsible for planning and coordinating the implementation of Regional and National Office Return Preparer strategy.

2. Establish viable communication lines between Planning and Special Programs (PSP), the District Electronic Filing (ELF) Coordinator, the CID Questionable Refund Program Coordinator (QRPC), the Service Center Examination RPC, and the CIB Return Preparer Coordinator. A major goal of the committee is to more effectively identify patterns of preparer abuse and prevent duplication of efforts within the Districts and Service Centers.

3. Meetings should be held at least monthly during the filing season and then quarterly throughout the remainder of the year. The committee meetings will focus on monitoring program results, analyzing methods, and making recommendations to the District Director concerning changes to the program.

4. The PSC will review all preparer penalty case files from whatever source prior to recommending the initiation of a project on an "identified" preparer. The written request will be forwarded for approval through the Chief, Examination Division, to the District Director. The District Director will make the final determination, in writing, approving or disapproving the request to initiate a Program Action Case (PAC). Under no circumstances will a sample of returns be examined without approval of the District Director or Assistant District Director. The following information should be included in the request for approval:

- a. The name(s) of the preparer, including business name.
- b. The SSN/EIN of the preparer.
- c. The address of the preparer, including business address.
- d. The areas of abuse identified.
- e. Attachment of pertinent examples of pages from the tax return(s) where the abuse was identified.

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- f. The source of the information, which resulted in the referral.

Upon approval the RPC should take the necessary action to establish a local project code for returns included in the PAC.

5. Coordinate activities of the site visitation teams. Visitations should be conducted on ELF and other preparers during the filing season that the team deems appropriate. Service Center reports, plus information referred from district office functions, i.e. the ELF Coordinator, site visitation teams and CIB in the service centers, will be used to identify potentially abusive preparers. Information obtained during the visitations will be used to recommend initiation of a PAC, if warranted. The following activities will be completed:

- a. Determine the number of teams needed to conduct visitations.
- b. Selection and formation of teams.
- c. Conduct orientation of team members on ELF requirements, return preparer provisions, authority to conduct visits, penalty assertions and referrals to the PSC.

6. Some cases received from CID may have refunds frozen. CID will refer scheme referrals to the RPC who will be responsible for forwarding the returns to the PSC. The PSC will decide within thirty days which returns will remain frozen with a TC 570 (civil freeze). The PSC will submit a list of the returns to remain frozen to CIB who will input the TC 570 before the 91X (criminal freeze) is released. CIB will release the 91X freezes on all returns in the scheme. Note: The District Director's approval is required for those returns where the refund remains frozen. (See Exhibit I - Request for Approval to Continue Freezing Refunds).

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Criminal Investigation and Examination Divisions

C. The Service Center Criminal Investigation Branch furnishes the District Criminal Investigation Division with leads on potentially abusive preparers who are filing seemingly fraudulent returns. Scheme referrals may also be received from CIB through Service Center Classification. The following actions should be taken by the District Examination and Criminal Investigation Divisions on potentially abusive preparer cases within the time periods prescribed.

Most cases will be generated during the filing season to address noncompliance. Early identification and intervention by Electronic Return Originator (ERO) site-visits is essential to stopping abusive refund schemes.

1. The District CID has ten workdays to number the referral/scheme as a primary investigation or forward to Examination.
2. Rejected referrals will be forwarded to the PSC for assignment and visitation by a multi-functional site visitation team, if warranted. The visitation will take place within twenty workdays after receipt of the case by the PSC.
3. The site visitation team will assert IRC section 6695 return preparer penalties, if warranted, recommend initiation of a PAC or no-action. Examiners may charge time for site visits to activity code 522. The PSC should review all recommendations and site visitation reports prior to submission of a request for approval to initiate a PAC. Initiation of a PAC requires the approval of the District Director.
4. Approved PAC files will be forwarded to the RPC for disposition of non-selected returns and to establish AIMS controls on all cases selected for examination.
5. The RPC should maintain statistical data on all referrals where return preparer penalties were asserted in order to determine in an expeditious manner the results of a particular PAC. All referrals should be tracked to determine the disposition, timeliness-of-actions, and reason for initiating or not initiating program action. Form 5809, Preparer Penalty Case Control card, is used to track results of a particular PAC. All cases, including related, prior and subsequent years, should be established on AIMS using source code 49, with an appropriate local project code. Results of each PAC should be furnished on a monthly basis to the PSC for evaluation.

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Examination Division

D. The Chief, Examination Division, may assign one or more tax auditors or Compliance Officers to the position(s) of Market Segment Specialization Program (MSSP) Return Preparer Specialist(s) assigned to office or field groups (optional at the discretion of district). These assignments will be made in accordance with NTEU negotiated agreement on MSSP agreements. Responsibilities of the position(s) should include:

1. Complete return preparer penalty cases using the following procedures: Time will be charged to the following activity codes:

- 501 - Negligence - IRC 6694(a)
- 502 - Willfulness - IRC 6694(b)
- 503 - Endorsing or Negotiating a Refund Check - IRC 6695(f)
- 504 - Identification Penalties - IRC 6695(a)-(e)
- 522 - Site Visitation Team Visits

a. Review case files upon completion by the examiner and secure the group manager's approval.

b. One case file per preparer may be compiled to assert all proposed penalties.

c. The Return Preparer Specialist will contact the preparer for a closing conference; if accepted, the manager of the group or local POD will be requested to attend if the case is unagreed. The following steps will be taken to complete the case:

(1) Fully develop and document the facts and circumstances regarding preparation of the return.

(2) The preparer's position will be fairly and carefully considered and clearly reflected in the penalty case work papers and on Form 5808, Return Preparer Penalty Follow-up.

(3) Appropriate copies of the income tax examination work papers, returns, and the Revenue Agent Report (RAR) will be included in the file. (Refer to IRM (20)(11)36:7 and Exhibit (20)(11)00-1 for a list of items that should be included in the preparer case file when appropriate).

d. Upon completion of the closing conference, the case will be closed by the examiner following the closing procedures for agreed or unagreed preparer penalty cases as outlined in IRM (20)(11)1(11), (20)(11)37, and (20)(11)14.

2. Additional assignments at the discretion of the District may include :

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a. Conducting and documenting interviews with noncompliant preparers to discuss problem areas in an effort to curb future noncompliance by the return preparer.

b. Referring information on return preparers suspected of involvement in questionable practices to the RPC. This information will be obtained by working with tax auditors and revenue agents.

E. Planning and Special Programs Branch currently is required to have a RPC. The individual occupying this position should undertake the following actions to ensure that questionable return preparers and the returns they prepare are identified:

1. The CIB's may have locally developed return preparer computer extracts. If available, these extracts may be used in conjunction with the PSP Preparer Inventory Listing (PIL) to identify returns for further research.

2. The RPC will analyze referrals on preparers forwarded by Service Center Classification as well as locally developed CI and Examination Division referrals.

3. The RPC should work with the District Disclosure Officer and/or Fed/State Coordinator to obtain leads from the local State Tax Agency on abusive return preparers. Information secured from the State should be evaluated in the same manner as that obtained from internally developed sources.

4. If the RPC determines from a review of the information that a PAC is warranted, then the RPC will take the following steps:

a. Request, if necessary, an appropriate sample of returns prepared by the subject preparer from the preparer's research file. The RPC will screen these returns to determine if they appear to warrant examination.

b. The RPC submits information contained in IRM (20)(11)17(6) to the PSC for preparation of a request to initiate a PAC on the return preparer.

c. Returns selected for examination as part of a PAC and approved by the District Director are assigned to examination groups by return preparer on a sample basis per IRM (20)(11)17(6).

5. After approval of a PAC, returns evaluated and selected for examination will be assigned by the RPC to a field or office group. The returns will be clearly identified as a "Return Preparer Program Action Case," and will include all pertinent information from the preparer's profile. All returns including related, prior and subsequent years, will be established on ADMS using source code 49 and the appropriate local project code.

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6. Returns received from Service Center Classification, through the PSC, may have TC 570 which is preventing release of the refund. When it is determined that cases with the TC 570 will not be examined, the RPC will be responsible for releasing the freeze with a TC 571 before sending the returns to file.

7. The Service Center RPC will forward copies of the first two pages of the related income tax return, a copy of the related income tax report, and copies of relevant work papers from the income tax case file for consideration of the assertion of preparer penalties to the District RPC. If penalty assertion is warranted, the RPC will assign the preparer file to an examination group.

8. At the direction of the District PSC, the District RPC will release frozen refunds (either partially or in entirety) on cases being held for examination.

9. In all situations in which refunds are held during an examination, the Director will have signed the proper approval form previously discussed.

F. Examination Guidelines - Group Manager and Examiner Responsibilities

1. Cases referred to the groups by the RPC will be examined under existing procedures and standards. Based on the results from the examination of the sample, it will be determined whether penalties or sanctions are warranted. If it is determined that return preparer penalties are warranted a preparer penalty case will be opened.

2. Each income tax examination is separate from the return preparer penalty case. Therefore, examiners will not propose identification or conduct penalties in the presence of the taxpayer.

3. Generally, no return preparer penalty will be proposed until examination of the individual returns at the group level is completed. However, if the preparer case is inseparable from the income tax examination, both cases may be completed simultaneously. If the income tax case is unagreed, the examiner may pursue the preparer penalty after the unagreed income tax case is submitted at the group level.

4. When penalties are not pursued, appropriate comments as to the extent of the review of any identification and/or conduct return preparer provisions will be documented in the work papers.

5. Comments proposing or discussing penalties against return preparers may not be appropriate when related criminal potential is under consideration against the taxpayer. These cases should be discussed with CID.

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6. If the examiner concludes that a penalty case should be pursued, the examiner will complete two copies of Form 6459, Return Preparers Check sheet, and discuss the recommendations with the group manager.

7. If the group manager authorizes the opening of a penalty investigation, he/she will document such authorization by signing the Form 6459. A copy of this form will be placed in both the preparer and the related income tax case files. The penalty case file may be forwarded to the Return Preparer Specialist, if the position exists in the district, (position should be established according to locally developed procedures) or the examiner, for completion in accordance with IRM (20)(11)1(11) and (20)(11)36. Note: The return preparer penalty account is not established or controlled on AIMS. Examiner must complete a Form 8278, Computation and Assessment of Miscellaneous Penalties.

8. Each manager and examiner should become familiar with IRM Chapter (20)(11)00.

9. The examination group manager is required to forward a written report to the Director of Practice when there is reason to believe that an attorney, certified public accountant, enrolled agent, enrolled actuary or appraiser has violated the rules set forth in the Treasury Department Circular No. 230.

10. A referral is also required if an agreed penalty under IRC sections 6694(a) and/or 6694(b) is obtained. This report should be routed for approval through the Chief, Quality Measurement Staff, Chief, Examination Division and signed by the District Director.

G. Each district should develop a follow-up system on preparers where penalties, suspension of filing privileges, and/or injunctive actions have been undertaken. Returns prepared in subsequent years by these preparers may be evaluated and selected for examination on a sample basis in order to determine the extent of continued noncompliance. Results from penalty assessments on return preparers should be obtained from Forms 5809 which are submitted to the RPC. Districts may find it beneficial to use the multi-functional site visitation team to determine compliance of return preparers identified as preparing abusive returns in preceding years. Information obtained by the team may be used to initiate program action on the preparer.

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II. Each Service Center/Compliance Center may initiate the following procedures:

Criminal Investigation Branch

A. The CIB Return Preparer Coordinator will work with the Service Center Examination RPC, CID, the District Examination RPC, and Electronic Filing Coordinator. This individual will be responsible for the following:

1. CIB will screen return preparer schemes and will distribute packages to CID in the District, as appropriate. Scheme packages not transmitted to District CID will be forwarded to the RPC in Service Center Classification.

2. CIB will set aside potential return preparer schemes for Service Center Examination Classification. Service Center Examination has ten workdays to classify the returns.

a. If accepted for examination, CIB will take the following actions:

(1) Check the module to determine if any condition other than the 91X is holding the refund (assuming the refund has not been issued). If not, input TC 570.

(2) Release the 91X freeze.

b. If rejected by Classification, CIB will release 91X and send returns back to files.

B. Potential return preparer cases should continue to be identified in each Service Center function per existing procedures. Non-criminal cases will be discussed with the Examination RPC at the Service Center, as warranted. The referral process is as follows:

1. Send information on potential criminal cases to the Service Center CIB for research and development.

2. In all instances Service Center CIB will discuss the characteristics of suspected preparer abuses either telephonically or by formal referral to District CID. When CID determines no criminal potential exists, the case will be referred to Service Center Classification.

3. Non-criminal cases will be sent to the Examination RPC at the Service Center for classification. Returns may be classified for examination by Correspondence Examination (CORR EXAM), District Examination, or returned to files. Refunds must be released on all cases going directly to District Examination RPC.

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Service Center Examination

C. Each Service Center Examination has a designated RPC as provided for by IRM 4(13)1(13).1. The Service Center Exam RPC will:

1. Screen and classify referrals received from the CIB RPC within ten work days of receipt. Cases may be selected for CORR Exam, District Examination or accepted as filed (non-select).

a. Cases selected for CORR Exam will be examined at the Service Center under existing procedures and standards. Every effort should be made to work these cases expeditiously since the cases may come from CIB with a TC 570 freezing the refund. Reports on cases where assertion of preparer penalties appears to be appropriate will be mailed to the Exam RPC in the appropriate District Office by the Service Center Examination RPC.

b. Cases with issues best examined in a face to face interview may be selected for District Office examination.

(1) The most egregious returns may be sent directly to the PSC with the refund frozen. Note: The PSC may make a recommendation to the District Director to continue freezing refunds while the case is in Examination (see previously discussed Request for Approval to Continue Freezing Refunds form).

(2) For other returns selected for the district, Service Center Classification will be responsible for ensuring the TC 571 is input to release the refund prior to sending them to the Examination RPC in the appropriate district.

(3) The Service Center Examination RPC will send these cases, whether to the PSC or district RPC, via Form 3210 after establishing the cases on AIMS.

c. Returns that have little or no examination potential may be accepted as filed (non-selected). These cases will not be on AIMS and once the TC 571 has been input to release the refund, the returns may be sent to files.

d. To ensure consistency of treatment of taxpayers within a particular preparer scheme, it is recommended that those cases be assigned to one CORR Exam group, whenever possible.

2. Cases selected for CORR Exam will be established on AIMS. The Service Center Exam RPC will ensure that these individual taxpayer returns are established on AIMS using source code 49 and an appropriate local project code.

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Request for Approval to Continue Freezing Refunds

We have reviewed returns prepared by the person shown below and believe there is adequate justification to continue to freeze the refunds of taxpayers on which he/she has prepared questionable returns. We ask for your concurrence on holding these refunds until the examinations are complete.

Name of Preparer:

Address:

Number of Taxpayers Involved:

Primary Issues Identified/Facts to be Considered:

Penalty Screening Member Approvals

Date

Date

Date

Date

Approve _____
District Director

Date

Disapprove _____
District Director

Date

Exhibit I

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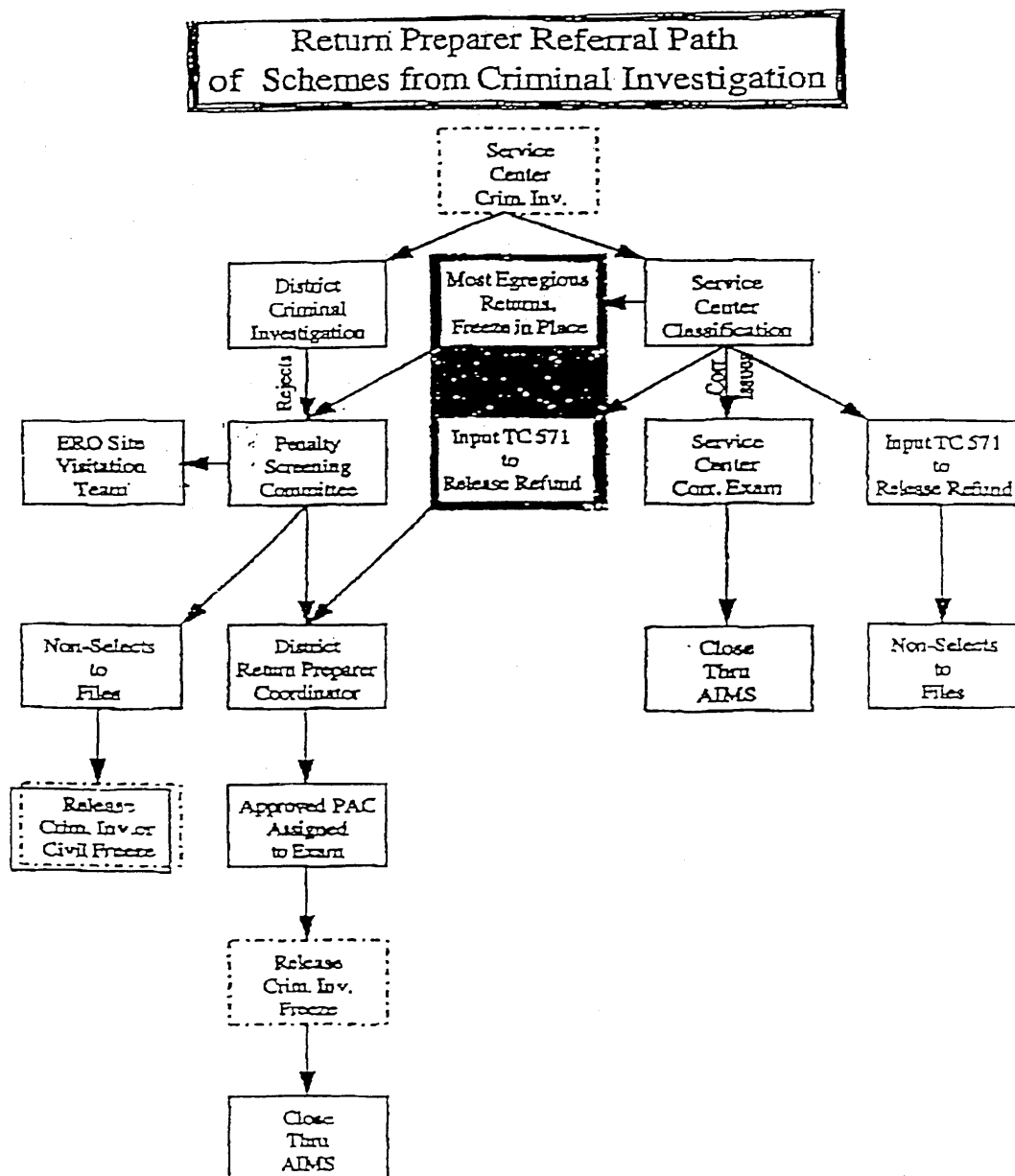


Exhibit II

Revision Date: August 2, 199